Are Your Assets Protected?
by Alan R. Eber

Building wealth through real estate requires knowledge, planning, discipline, investment capital and opportunity. Building wealth also depends on your ability to analyze and manage risks wisely and avoid catastrophic risks that destroy wealth. You avoid catastrophic real estate losses by proper use of legal entities to isolate risk and personal liability. Many learn about risk the hard way, after they have lost their money in a lawsuit that might have been avoided with proper planning.

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Lawsuits are commonly brought by attorneys paid a percentage of what they extract from you. A successful asset protection plan eliminates most lawsuits by removing the predator's economic incentive. There is nothing an attorney likes less than winning and then not getting paid.

The following are a number of basic and advanced real estate asset protection techniques.

Basic Real Estate Asset Protection

Transfer to Family Limited Partnership (FLP) or Limited Liability Company (LLC). A creditor of an FLP partner or LLC member may only obtain a charging order (a lien) against the entity and cannot get at the real estate. This charging order protection may be substantial; however, there is a question as to whether it can be unconditionally relied on. Most seasoned litigators would agree that confronting a judge with the proposition that he is powerless to enforce a judgment, because of the charging order rules, while at the same time seeing property within his judicial reach, is a challenge few debtors should want to face.

Protection by Equity Stripping is an effective technique for protecting property. Equity stripping refers to encumbering property with debt to reduce its net value and make it less attractive to creditors.

When a lender loans money secured by property, he has a priority in the event of default or disposition of the property. If a property is worth $500,000 and has a $475,000 lien, a creditor likely will not pursue that property, which has, after a rushed sale and a real estate commission no equity.

Cash is easier to protect than real property, because it can be moved out of the reach of creditors. Real property, on the other hand, is always subject to the jurisdiction of the court where the property is located and totally subject to local law and the orders of the local court.

Commercial Equity Stripping involves a commercial lender loaning cash with the property securing the loan. A lien is placed on the property and recorded. Creditors will have insurmountable difficulty in defeating the lender's lien. The downside is that commercial lenders demand regular payments, which may be difficult once a creditor appears. Also, lenders typically loan only 80 percent. No lender will make a loan if there is a pending or existing judgment.

Private Equity Stripping involves the use of a trusted person to create an entity to act as lender to the owner. The lender loans money secured by a recorded lien against property. Because the lender has a close relationship with the owner, there is more flexibility. The loan may be a balloon obligation requiring no payments until the end of the loan term, the property may be encumbered up to its full market value, provisions of the loan such as penalties, a high interest rate upon default and high fees in the event of foreclosure can make the property unattractive.

Contingent Equity Stripping involves the use of lines of credit secured by property. If a potential creditor appears, the line of credit is exercised, stripping equity from the property. The lien should be filed well in advance of creditor troubles or it may be deemed a fraudulent transfer.

Collateralization via FLP/LLC. As part of capitalizing an FLP/LLC, a promissory note could be contributed. The FLP/LLC, as an entity independent of you, and to ensure you make your note payment, could place a lien on your real estate, effectively removing all remaining equity.

Negatively Amortizing Note. If the note you give is negatively amortized, you would owe more at the end of each year therefore shielding equity which increased due to appreciation.

Advanced Real Estate Asset Protection

Domestic Asset Protection Trust (DAPT): An investor can transfer real estate to a DAPT in a state where such trusts provide asset protection. The problem is the real estate is not in the state offering the protection. For instance: a creditor of a California debtor who has transferred his Califomia real estate to an Alaskan trust. Does the creditor have to sue in Alaska or can he proceed against the California real estate? Although the issue is unsettled, many people use this technique to protect their real property.

Loan via Foreign Asset Protection Trust (FAPT) involves obtaining a loan for the equity in the property from an offshore bank. The bank will want a trust deed to secure the loan. The loan proceeds are placed in a CD with the lending bank and pledged to secure payment of the loan. When the threat of a lawsuit is no longer a concern, the CD may be applied to liquidate the loan and the trust deed will be discharged.

The most significant feature of a solid asset protection plan – the moving of assets to a jurisdiction not readably accessible and decidedly unreceptive to creditors – is not available for real estate. Nevertheless, there are a number of methods, whether used alone or in combination with one another, which can provide a wall of protection designed to withstand a creditor's attack.

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